Maalot

S&P Global Ratings

Brack Capital Properties N.V.

September 8, 2022

Rating update

Lowering the Company's rating to 'ilBBB-' and the ratings of the bond series to 'ilBBB+' following our assessment that the Company has limited access to funding sources and its liquidity is weak; Leaving the ratings in credit watch with negative consequences

Chief Credit Analyst:
Evgeni Silishtian evgeni.silishtian@spglobal.com 972-3-7539733

Secondary Contacts:

Gil Avrahami gil.avrahami@spglobal.com 972-3-7539712
Yair Dyk yair.dyk@spglobal.com 972-3-7539739

Index

Lowering the Company's rating to 'ilBBB-' and the ratings of the bond series to 'ilBBB+' following our assessment that the Company has limited access to funding sources and its liquidity is weak; Leaving the ratings in credit watch with negative consequences.

Rating activity summary

- In August 2022, LEG (LEG Immobilien SE), which indirectly holds approximately 35.7% of Brack Capital's shares announced that it does not intend to initiate a tender offer for the remaining shares it does not own.

- As a result, and given the current ownership structure, we believe that Brack Capital's accessibility to the banking system in Germany has been compromised. Among other things, the Company has not completed long-term refinancing of outstanding bank debt secured by income-generating assets and we estimate that there is a high reliance on a credit line provided by the parent company Adler Real estate AG (CCC/Negative "Adler Group"). In view of the foregoing and given the maturities burden and the liabilities' duration, we estimate that the Company's liquidity is weak and the capital structure is negative for the rating.

- Given the Company's leverage, which was approximately 43.3% at the end of the first half of 2022, the type of real estate assets it owns and the existing debt mix, we estimate that the debt rehabilitation evaluation score is '1' and reflects our assessment that the debt rehabilitation rate is expected to be higher than 90%.

- On September 5, 2022, we lowered the issuer rating of Brack Capital Properties NV from ilA-' to ilBBB-' and the ratings of its bond series (series B and C) from 'ilA' to 'ilBBB+'.

- Leaving the Company's ratings in the credit watch with negative consequences mainly reflects our assessment of Brack Capital's liquidity situation, since in our opinion, there is substantial reliance on the credit facility provided by the parent company, which is characterized by low credit quality and is exposed to insolvency. Also, we wish to continue examining the negative impact of the Adler Group on the rating characteristics of the Company.

Major considerations for the rating activity

We believe that the weakening of the credit quality of the Adler Group has a negative effect on the credit quality of the Company and in particular on its accessibility to the banking system in Germany. Among other things, the Company did not complete substantial long-term refinancing of bank loans secured by real estate assets. In May 2022, the Company entered into an agreement with the Adler Group according to which the Company will be provided with a credit facility in several frameworks totaling EUR 200 million. In August 2022, there was an update in the terms of the credit, among other things, it was reported that it will also be available for the purpose of refinancing a financial liability of the Company which is scheduled to be repaid during 2023. In our opinion, at this stage the financing sources rely substantially on the credit facility provided by the parent company, from which the Company has drawn down EUR 100 million in the second quarter of 2022. As a result, our concerns intensified regarding the ability of Brack Capital to complete refinancing, mainly in view of its relatively high debt maturities in the next 12 months, so we now estimate that the Company's liquidity is weak. Also, the maturities burden and the lack of long-term refinancing led to shortening the debt duration thereby reflecting a capital structure which, in our opinion, has a negative effect on the rating.

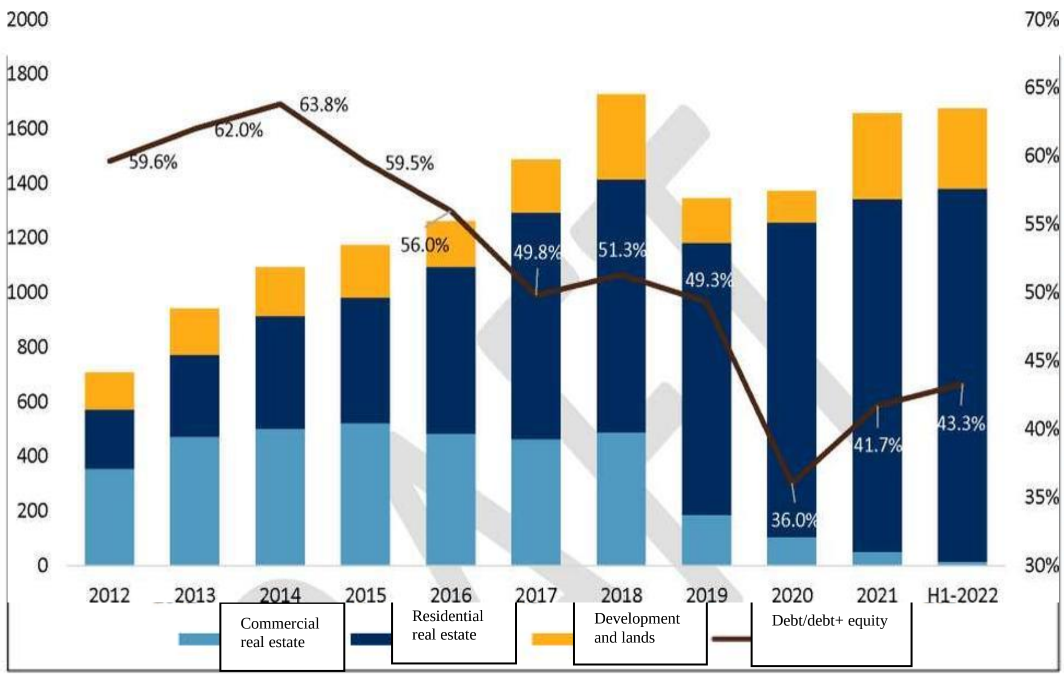
The operational performance and the increase in the value of the asset portfolio support the business profile, the scope of development remains limited. In the second quarter of 2022, the Company presented a growth of about 4% in rent from identical properties in the residential income generating real estate sector, compared to the corresponding quarter last year. The Company's rents in new rentals in the residential sector were about 11.6% higher compared to the current average. The average occupancy rate remained high and stable and amounted to approximately 97% and the value of income generating asset portfolio increased and amounted to approximately EUR 1.37 billion compared to approximately EUR 1.32 billion at the end of 2021.

Weakening of the financial risk profile from erosion in the interest coverage ratio following a substantial increase in financing expenses. In the first half of 2022, there was an erosion in the interest coverage ratio and it amounted to approximately 1.6x compared to 3.0x in 2021. The decrease is attributed to an increase in the interest rate which is adjusted mainly at the backdrop of an increase in the debt volume (including an increase in the bonds' volume), to increase in inflation in Israel (since the bonds are linked to the CPI) and the increase in interest (among other things, as a result of the weakening of the Company's credit quality). We estimate that further erosion will be in interest coverage ratio and it is expected to be 1.2x – 1.4x in 2022-2023. Our estimates mainly reflect the expected increase in debt, the increase in bond interest due to the erosion of credit quality, an increase in financing costs due to linkage (since the Company's bonds are linked to the consumer price index), based on the inflation expectations of S&P Global Ratings, and our assessment that an increase in interest rates will take place in new financing.

Moderate increase in leverage, but it remains relatively low. The adjusted ratio of debt to debt and equity amounted to approximately 43.3% at the end of the first half of 2022, compared to approximately 41.7% at the end of 2021. The increase in leverage was due to an increase in the adjusted financial debt to approximately EUR 674 million at the end of the first half of 2022 compared to approximately EUR 651 million at the end of 2021 and a decrease in equity to approximately EUR 882 million at the end of the first half of 2022 compared to approximately EUR 911 million at the end of 2021.

The increase in debt was mainly due to negative cash flow from operating activities in the amount of approximately EUR 11 million mainly due to investments in development projects, cash flow of approximately EUR 5 million that was used for investing activities (mainly capital investments in existing assets and development costs of real estate under construction in a total amount of approximately EUR17 million, offsetting a consideration of approximately EUR 16 million from the sale of commercial assets) and the effect of linkage in the amount of approximately EUR 5 million. The decrease in equity mainly resulted from a loss of approximately EUR 29 million, which included approximately EUR 11 million of impairment of inventory of apartments under construction, a loss of approximately EUR 7 million from a financial investment in a German startup company, a provision of approximately EUR 22 million related to tax liability that is expected to result for the Company following completion of the purchase of the Company's shares by LEG (in view of the tax laws applicable in Germany), adjusted financing expenses of approximately EUR 11 million and a loss due to financial derivatives for currency hedging and the effect of exchange rate differences in the total amount of approximately EUR 20 million. The loss was offset by an increase in the value of investment property in the amount of approximately EUR 2 million and NOI (net operating income) in the amount of approximately EUR 25 million for the first half of the year.

Figure 1: development of the asset portfolio and leverage



We estimate that in 2022-2023 the leverage will moderately increase so that the adjusted debt to debt and equity ratio will be in the range of approximately 43% -45%. Our assessment mainly reflects an expectation of an increase in the adjusted debt as a result of an increase in interest payments, the payment of tax in view of the purchase of the Company's shares by LEG as aforesaid and making capital investments in the existing assets and in development projects, offsetting the expected consideration upon completion of realization of the commercial assets classified for sale and cash flow from the residential income generating real estate sector.

We believe that the Company's management strategy relies, among other things, on the Group's strategy. At the group level, the corporate governance framework is not sufficiently clear and transparent, with frequent changes in strategy and holdings structure that have limited its ability to meet its operational and financial objectives. Also, the rotation of Brack Capital's senior management and group companies has been high in recent years including the resignation of four directors and a co- CEO in Adler following the findings of an investigation conducted by Adler's previous auditor, KPMG, according to which irregularities in corporate governance and compliance were discovered. We estimate that there is a weakness in Brack Capital's corporate governance similar to the weakness in corporate governance of Adler group companies. The fact that the current CEO also serves as co-CEO of the Adler Group, as well as the former CEO and he also serves as a director of the Company, supports this assessment.

Credit watch

Leaving Brack Capital's ratings in the credit watch with negative consequences reflects mainly the liquidity situation of Brack Capital since we believe that there is a substantial reliance on the credit facility provided by the parent company which is characterized by low credit quality and is exposed to insolvency. In addition, we wish to continue examining the negative effect of Adler Group on the rating characteristics of Brack Capital.

We intend to remove the Company's ratings from the credit watch in the upcoming months when we are more certain about the Company's accessibility to diverse financing sources.

We may lower the Company's rating by one Notch or more if we estimate that the Company's liquidity and its accessibility to diverse financing sources has further deteriorated.

Company description

Brack Capital Properties N.V. is an income-generating real estate company operating in Germany. On June 30, 2022, the value of the Company's income-generating assets portfolio was approximately € 1.37 billion and it included 12,158 residential units and five income-generating commercial properties with a leasable area of approximately 720 thousand square meters. In addition, the Company is engaged in the development of land complexes for residential development and improvement of lands in the city of Düsseldorf and in the city of Aachen. The Company currently has no marketing projects.

The Company is 63% held by Adler Group, about 35.7% is held by LEG and the remainder is held by the public.

Base scenario

Our base scenario is based on the key assumptions as follows:

- Severe harm to the economy in Europe following the Russian – Ukrainian conflict and the response of the western world. S&P Global Ratings forecasts that in 2022 Germany will show a growth of about 1.9% in GDP and inflation of about 7.6%, and unemployment rate of about 3.0%.
- In Israel, S&P Global Ratings forecasts that in 2022 inflation will be about 3.8% (the bond series are traded in Israel and CPI linked).
- A high and stable occupancy rate of about 95% and stability in rents, mainly based on the Company's presence in cities with good demographic data and a stable demand for rental apartments.

- Annual NOI from the income generating real estate sector of approximately € 45-50 million in 2022-2023, given a contribution from Stage I of the Garfantel project the construction of which was completed and moderate growth in existing assets excluding profits from the residential development sector.
- Completion of realization of commercial properties classified as held for sale in 2023, totaling approximately € 14 million.
- Investments at an annual scope of approximately € 45-55 million in 2022-2023, mainly capital expenditures (capex) in existing assets and investments in the development of new assets.
- A tax payment of up to € 30 million as a result of the acquisition of the Company's shares by LEG, in accordance with German tax law.
- Refraining from dividend distribution.

Under our base scenario the coverage and leverage ratios are expected to be as follows:

- Adjusted EBITDA to financing expenses ratio of 1.2x – 1.4x in 2022 and 2023.
- Adjusted debt-to-debt and equity ratio of approximately 43% -45% in the years 2022-2023.

Liquidity

We estimate Brack Capital's liquidity level to be weak, among others, based on our estimate that the ratio between the Company's resources to its uses is materially low than 1.0x in the 12 months beginning July 1, 2022. The sources included in our calculation do not include the unused balance of the credit facility from the Adler Group considering the low credit quality of the Group. In addition, the indications that the Company's accessibility to the German banking system was compromised because of the attribution to the Adler Group adversely effects our liquidity estimate. Moreover, the fact that most of the Company's assets are charged has a negative effect on the estimate of financial flexibility, although the bank debt is non-recourse and the average loan-to-value (LTV) rate against the charged assets at the end of the second half of 2022 was relatively low amounting to 38%, which may support the Company refinancing ability.

In our base scenario we assume that the sources available to the Company in the 12 months commencing on January 1, 2022 are:

- Cash and cash equivalents of € 130 million.

Our assumptions regarding the Company's uses in that period are:

- Short term credit and payment of net debt maturities of € 253 million (including three "Bullet" payments for non-recourse bank loans for income generating residential portfolio in September and November this year and June 2023, at a total scope of € 184 million and bond maturity of € 63 million at the end of the year).
- Negative cash FFO (funds from operations) of € 2-4 million (our estimate).
- Current investments in current assets (capex) of € 15-25 million.

Covenant analysis

The Company has a number of financial covenants to banks and bondholders. To our understanding, the Company has an adequate margin in relation to the financial covenants as of June 30, 2022.

The Group's impact

We believe that the quality of the Company's credit is adversely effected as a result of the weakening of the credit quality of the parent company, Adler Real Estate AG (CCC/Negative), which holds approximately 63% of the Company's shares and of the controlling shareholder, Adler Group SA (CCC/Negative) which holds approximately 97% of the parent company.

On May 5, 2022, S&P Global Ratings lowered the ratings of these two companies, in view of the increasing concerns about its ability to refinance its debts, among other things, in view of the non-renewal of a financing framework for working capital needs that expired in March 2022 (in the amount of approximately €15 million) and our understanding that a credit facility held by the Adler Group (in the amount of € 300 million) was canceled, which reduced its liquidity margin. In addition, the Adler Group reported non-compliance with a financial covenant related to its uncharged assets, which limits its ability to raise additional financing.

As a result, S&P Global Ratings expressed concern as to Adler Group's ability to meet its upcoming bond maturity in April 2023, and several additional secured debt maturities, through organic cash flow generation, and expected that Adler would have to rely significantly on asset realization. Additionally, Adler Group's annual financial statements included a qualification of its auditor, KPMG, according to which it is unable to express an audited opinion on the consolidated financial statements, which may indicate that Adler's ability to meet its near-term financial liabilities has further decreased. The negative outlook on Adler Group's ratings reflects S&P Global Ratings' assessment that there may be an additional negative rating activity if the group fails to resolve the auditor's qualification as soon as possible, accumulate cash and find financing solutions in the next 12 months.

We estimate that the weakening of Adler's credit quality has an adverse effect of the Company's rating, however, at this stage, we believe that there is a justification for a certain separation between the Company's ratings and Adler Group ratings. This estimate reflects, inter alia, the fact that Brack Capital operates as a separate and independent entity and we do not expect a negative extraordinary intervention on the Group's part in the short to middle term; Our assessment is supported by the appointment of two directors during the year, one an external director and the other an independent director, and the composition of the current board of directors, which includes seven directors, of which four are independent and external directors. We also take into account the current holdings structure in the Company, which includes a substantial minority holding by LEG (about 34.5%) which invested about € 320 million cumulatively in the Company's shares. As per our estimate, the presence of substantial minority shareholders with an economic interest may create significant limitations on the Group's ability to influence the Company in a way that will not be in the best interest of its shareholders.

We note that, to our understanding, Israeli regulation includes strict corporate governance rules and approval processes, mainly regarding transactions involving interested parties. In our opinion, several provisions in the Companies Law support adequate corporate governance rules for groups and strengthen the minority's ability to prevent transactions with interested parties that are not in the best interest of the Company. Therefore, we estimate that the law limits the ability of the controlling shareholders to intervene in public subsidiaries (or in bond companies) in a way that may harm the best interest of the Company.

However, in the coming months we will examine whether there has been a further deterioration in the Group's credit quality, and whether this has a material effect on Brack Capital's activities, and particularly on its financing capabilities. To the extent that there is further weakening in the ratings of the Adler Group, it is feasible that there will be additional negative pressure on the Company's rating.

Rating adjustments

Sectoral distribution: neutral

Capital structure: neutral

Liquidity: weak

Financial policy: neutral

Management, strategy and corporate governance: weak

Comparison to reference group: neutral

Debt recovery analysis

Major considerations

- We lower the rating for the bond series of Brack Capital Properties (Series B and C) to 'ilBBB+' two levels (Notch) above the issuer's rating from 'ilA'. We raise the debt recovery rating for these series to '1' from '2' which reflects our estimate that given a hypothetical nonpayment scenario, debt recovery rate will be higher than 90%.

- Our estimate of the debt recovery rate is supported, among others, by the relatively low leverage level, the existing and expected debt mix, including the ratio between the secured debt and unsecured debt and the type of real estate assets the Company owns. Changes in leverage and debt mix may have an effect of the debt recovery estimate and the bond series rating.

Key assumptions for hypothetical nonpayment scenario

- Year of hypothetical nonpayment event: 2024

- A deep recession in German economy will cause a significant reduction in occupancy rates, a decrease in rental fees and substantial erosion in the value of the asset portfolio, which will impair materially the Company's ability to meet debt repayments.

- The Company will continue to operate as a going concern, an estimate which is supported by the key locations of its assets and adequate operational performance.

- The value of the Company's commercial asset portfolio will decrease by 50%, considering the concentration value of a number of large assets.

- The value of the Company's residential asset portfolio will decrease by 30%, considering the distribution of tenants and the relatively high number of assets.

- The value of inventory under construction for sale and land by the Company will decrease by 70% considering the locations, engineering completion rates, marketing rates, planning status and building permits status.

Basic payment waterfall upon nonpayment

- Value as going concern (gross) at asset value: € 1,049 million.

- Administrative costs: 5%

- Available value to cover secured debt: € 996 million.

- Total secured senior debt: € 500 million (including use of credit facilities).

- Available value to cover unsecured debt: € 497 million.

- Total unsecured debt (Series B and C): € 345 million.

- Estimate of the unsecured debt recovery rate: above 90%.

- Debt data include semiannual accrued interest.

Impact of Debt Recovery Estimate on Debt Rating with respect to Issuer's Rating			
Debt recovery estimate in percentage	**Description**	**Score of debt recovery estimate**	**Rating of series above/under the issuer's rating**
100%	Full repayment expected	1 +	3+ notches
90%-100%	Very high debt recovery	1	2+ notches
70%-90%	High debt recovery	2	1+ notch
50%-70%	Significant debt recovery	3	0 notches
30%-50%	Average debt recovery	4	0 notches
10%-30%	Modest debt recovery	5	-1 notches
0% - 10%	Negligible debt recovery	6	-2 notches

Debt recovery ratings are limited in some countries to take into account reduced debt recovery prospects in those countries. Debt recovery ratings of unsecured debt issuances are also generally limited (for more information, see Step 6, paragraphs 90-98 of the Methodology for Evaluating Debt Recovery of Non-Financial Corporations, December 7, 2016).

ESG indicators in Credit rating

Corporate governance factors are very negative consideration in analyzing the credit rating of Brack Capital Properties N.V. because its strategy relies in part on Adler Group's broad strategy and the group's corporate governance framework is not sufficiently transparent. Frequent changes in the group's strategy and holding structure, in our opinion, limit its ability to meet its operational and financial targets. We believe that the high rotation in the senior management of Brack Capital Properties and other companies in the group indicates a weakness in the corporate governance of Brack Capital Properties. The fact that the CEO of the Company also serves as co-CEO of the group and as a director of the Company supports this estimate.

ESG indicator	E-2	S-2	G-5
ESG factor	NA	NA	Corporate governance structure; Risk management, culture and supervision; Other corporate governance factors

ESG indicators in credit rating provide additional disclosure and issuer-level transparency and reflect S & P Global Ratings' estimate of the impact of environmental, corporate and corporate governance factors on our credit rating analysis. ESG indicators are not a credit rating, sustainability rating or ESG rating. The degree of effect of these factors is expressed on a scale of 1 to 5, where 1 = positive effect, 2 = lack of effect, 3 = moderate negative effect, 4 = negative effect, and 5 = very negative effect. For more information, see ESG Indicator in Credit Rating - Definitions and Application, from October 13, 2021.

Methodology and Related Articles

- Methodology: general: S& P rating principles, February 16, 2011.
- Methodology: methodology for assessing the management and corporate governance of corporations and insurers, November 13, 2012;
- Methodology: sector risk, November 19, 2013.
- Methodology: methodology for estimating country's risk, November 19, 2013.
- Methodology: general methodology for rating corporations November 19, 2013.
- Methodology: methodology for assessing the liquidity profile of corporations, December 16, 2014.
- Methodology: methodology for assessing debt recovery of non-financial corporations, December 7, 2016.
- Methodology: key factors for rating real estate companies, February 26, 2018.
- Methodology – General: credit rating in local scales, June 25, 2018.
- Methodology: methodology for calculating financial ratios and adjustments, April 1, 2019.
- Methodology – general: rating companies in a group, July 1, 2019
- Methodology – general: credit risks from environmental factors, company and corporate governance, October 10, 2021.
- Rating definitions of S&P Global ratings, November 10, 2021.
- Opinions and interpretation: the link between the global rating scale and the Israeli rating scale, June 26, 2018.
- Methodology – general: methodology for using ratings in the CC and CCC groups, October 1, 2012.

List of ratings

Brack Capital Properties N.V	Rating	The date in which rating was issued for the first time	The last date on which rating was updated
The issuer's rating			
Long term	**ilBBB-/Watch Neg**	**April 1, 2012**	**February 15, 2022**
Unsecured senior debt			
Series B	**ilBBB+/ Watch Neg**	**April 3, 2013**	**February 15, 2022**
Series C	**ilBBB+/ Watch Neg**	**June 23, 2014**	**February 15, 2022**
Issuer's rating history:			
Long term			
September 7, 2022	**ilBBB-/ Watch Neg**		
May 16, 2022	**ilA-/ Watch Neg**		
February 15, 2022	**ilAA-/Watch Neg**		
December 9, 2021	**ilAA-/Negative**		
October 14, 2021	**ilAA-/Watch Neg**		
March 15, 2016	**ilAA-/stable**		
April 3, 2013	**ilA+/stable**		
April 1, 2012	**ilA/stable**		
Additional details			
The time the event has occurred	April 5, 2022 10:29		
The time it was first learned about the event	April 5, 2022 10:29		
The party initiating the rating	The rated company		

In order to maintain the independence and the lack of dependence of the activities of the various units of S & P, S & P maintains these activities separated. As a result, certain units may have information that is not available to other units of S & P. S & P has formulated procedures and processes in order to maintain the confidentiality of non-public information obtained in connection with the analytical processes it performs.

S & P receives financial consideration for providing rating services and analyses it performs, usually from the issuers, or the underwriters of the rated securities or the debtors. S & P reserves the right to disseminate its opinions and analyzes. The public ratings of S & P ratings and the analyses appear in the website of S & P Maalot at www.maalot.co.il and in the website of S & P at www.standardandpoors.com which can also appear in other publications of S & P and third parties.